

**ASIAN DEVELOPMENT BANK**

**TAR: KGZ 35262**

**TECHNICAL ASSISTANCE**

**TO THE**

**KYRGYZ REPUBLIC**

**FOR**

**STRENGTHENING CAPACITY OF THE MINISTRY OF FINANCE**

**FOR FINANCIAL MANAGEMENT AND PLANNING OF**

**THE PUBLIC INVESTMENT PROGRAM, PHASE II**

**November 2001**

## **CURRENCY EQUIVALENTS**

(as of 1 October 2001)

|               |   |           |
|---------------|---|-----------|
| Currency Unit | – | Som       |
| Som1.00       | – | \$0.02096 |
| \$1.00        | – | Som47.7   |

## **ABBREVIATIONS**

|      |   |                                       |
|------|---|---------------------------------------|
| ADB  | – | Asian Development Bank                |
| GDP  | – | gross domestic product                |
| IMF  | – | International Monetary Fund           |
| MOF  | – | Ministry of Finance                   |
| PIP  | – | Public Investment Program             |
| PRGF | – | Poverty Reduction and Growth Facility |
| TOR  | – | terms of reference                    |
| TA   | – | technical assistance                  |

## **NOTES**

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report “\$” refers to US dollars.

## I. INTRODUCTION

1. In December 1999<sup>1</sup>, the Asian Development Bank (ADB) approved technical assistance (TA) to improve the financial management and prioritization of the public investment program (PIP) in the Kyrgyz Republic. Following TA completion in July 2001, the Government asked ADB to provide a second phase TA. The TA completion report rated the TA “Successful.”<sup>2</sup> The TA’s output has proved to be highly useful to the Government. It has convinced the Government and assistance community of the need to prioritize existing PIP projects and has helped considerably to offset resistance to reducing the allocations for, or pruning the size of, low priority projects. Sustainability of this effort will depend on timely implementation of the second phase TA. The ADB TA Fact-Finding Mission carried out detailed discussions in August-September 2001 with concerned officials of the Ministry of Finance (MOF) and reached understandings on the objectives, scope, terms of reference, implementation arrangements, and cost estimates of the second phase TA.<sup>3</sup> The TA framework is in Appendix 1.

## II. BACKGROUND

2. The Government has been maintaining a large PIP to sustain a high level of aggregate investment in economic and social infrastructure. Since domestic savings are grossly inadequate to finance the level of investment, over 80 percent of the PIP is externally funded. This, over a short period of time, contributed to increasing the public external debt from virtually nothing at the time of independence in 1991 to about 44 percent of gross domestic product (GDP) by 1997. During the next two years, the external debt burden rose sharply to 91 percent of GDP by 1999, due largely to the depreciation of the national currency following the Russian Federation’s financial crisis in 1998. The sudden increase in the size of public external debt made public finances unsustainable and raised serious concerns about sustainability of the PIP at its current levels. The difficult fiscal situation severely affected the availability of counterpart funds for ongoing projects leading to delays in project implementation. This and inefficiencies in implementation are increasingly seen to be eroding the efficacy of PIP projects. Mounting debt and fiscal sustainability considerations prompted the International Monetary Fund (IMF)-supported Poverty Reduction and Growth Facility to prescribe a sharp reduction in fiscal deficits and consequently limit the level of the PIP from about 7 percent of GDP in 2000 to about 3 percent of GDP by 2004. The envisaged compression of the PIP means that the absolute amount of resources available will not be sufficient to finance all ongoing projects in the pipeline and still have enough room for a limited number of high priority new projects. This created a situation where the Government had to evaluate the existing portfolio of projects so that scarce resources are available for a limited number of efficiently implemented high priority projects. Consequently in late 1999, the Government requested ADB TA to strengthen its capacity to plan, prioritize, and manage the PIP so that it would be able to comply with IMF requirements. The first phase TA was, accordingly, approved in December 1999.

3. The scope of the first phase TA comprised (i) review and suggest refinements to the organizational structure of MOF with a view to improving flow of information and implementation of PIP projects, (ii) analyze and improve MOF capacity to coordinate with line ministries and other implementing agencies for effective PIP management, (iii) improve the methods of project

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<sup>1</sup> TA 3382-KGZ: *Strengthening Capacity in the Ministry of Finance for Financial Management and Planning of the PIP*, for \$463,500, approved on 28 December 1999.

<sup>2</sup> IN.225-01-KGZ: *Strengthening Capacity in the Ministry of Finance and Planning of the PIP*, October 2001.

<sup>3</sup> The TA was first listed in *ADB Business Opportunities* (Internet edition) on 7 September 2001.

appraisal and prioritization followed in MOF to internationally acceptable standards, (iv) design and set up a reliable financial reporting and monitoring system, (v) enhance the Government's capacity to estimate the impact of the PIP on recurring costs and make medium-term forecasts, (vi) help MOF to review all the PIP projects under implementation and prioritize them to determine budgetary allocations, (vii) identify training requirements and train MOF and other concerned staff, and (viii) examine the existing administrative and legal framework governing PIP management and make recommendations for improvement.

4. The first phase TA produced visible and highly useful benefits to the Government as well as financing agencies. It successfully raised awareness of the need to prioritize the PIP and helped gain acceptance from stakeholders such as the line ministries and funding agencies to reduce the size of allocations for, or to prune the size of, low priority projects. The TA also helped the Government to reappraise the existing portfolio of projects to prioritize allocation of resources in the 2001 budget. The first phase TA was very successful in this strategically important aspect of PIP management. The TA developed a basic project monitoring and financial reporting system, provided valuable inputs for the preparation of the Public Debt Act and the draft Budget Law to strengthen public expenditure control and rationalize management of the PIP and external debt, assisted in integrating the PIP into the budgetary forecasting process, and trained staff from MOF and other key economic ministries and agencies. The Public Debt Act was passed in September 2001. Even though the first phase TA completed all activities as planned, its impact on the specific objectives varied. The TA's most valuable contribution was sensitizing the Government and the funding agencies of the need to prioritize projects, and to actually carry out the prioritization exercise to determine the 2001 budget allocations on a more rational basis. In some of the more technical and complex areas, the TA provided valuable assistance to the Government but further steps are needed. This was anticipated as strengthening PIP management is a difficult task, which can be achieved only in the medium term. The TA has improved staff understanding of the requirements of PIP management and prepared them to receive more complex inputs. Training under the TA covered the highest priority areas of financial analysis, project cycle, and basis project appraisal techniques.

### **III. THE TECHNICAL ASSISTANCE**

#### **A. Objective**

5. The objective of the second phase TA is to strengthen the Government's PIP management capacity and sustain progress made by building on the work done under the first phase TA.

#### **B. Scope**

6. The TA will achieve its objective by (i) helping the Government prepare a medium-term PIP forecast to determine an optimal mix of budgetary resource allocation for new and old projects; (ii) institutionalizing the project appraisal and PIP prioritization processes with follow-up training and development of appropriate regulations and manuals; (iii) enhancing the scope of monthly reporting and the monitoring systems to ensure strict adherence to budgeted spending allocations and to enable forecasting of expenditure requirements based on the physical progress of projects; (iv) reviewing the links between the PIP Department and project implementation units with a view to improving information flows particularly relating to accrued expenditures and contractual commitments to achieve greater control over PIP spending and its impact on the budget; (v) instituting procedures and methods to increase coordination between

staff of the project implementation units and the PIP Department to accurately estimate the recurrent costs of completed projects and those under completion; (vi) improving coordination between the PIP Department and line ministries to streamline the identification and ranking of new high priority projects, speed up project implementation, and improve interministerial coordination for better project implementation; (vii) assessing staff training requirements and carrying out training; and (viii) assisting the Government with implementation of the new Budget Law (outline terms of reference for the consultants are in Appendix 2).

### **C. Cost Estimates and Financing Plan**

7. The total cost of the TA is estimated at \$706,000 equivalent, of which \$524,000 is the foreign exchange cost and \$182,000 equivalent the local currency cost. ADB will provide \$600,000 equivalent to finance the entire foreign exchange cost of \$524,000 and \$76,000 equivalent of the local currency cost. The TA will be financed by ADB on a grant basis from the ADB-funded TA program. The Government will finance the remaining local currency costs of \$106,000 equivalent through the provision of office space, staff support, and other items. Detailed cost estimates are in Appendix 3.

### **D. Implementation Arrangements**

8. MOF will be the Executing Agency. The TA will be implemented over 18 months with consulting services to be provided by (i) an international consultant (18 person-months) as adviser on the PIP policy, (ii) an international training consultant (2 person-months) with specialization in training related to financial forecasting and PIP management, and (iii) two domestic consultants (36 person-months) in the field of financial and system management. Both international consultants will be recruited on an individual basis in accordance with ADB's *Guidelines on the Use of Consultants*, other arrangements acceptable to ADB will be followed to select the domestic consultants. All procurement of equipment and materials will be in accordance with procedures satisfactory to ADB. The TA is expected to commence in January 2002 and conclude in June 2003.

9. The PIP adviser will provide an inception report to MOF and ADB within one month of the commencement of services. This report will make an initial assessment of work keeping in mind the terms of reference, prepare a realistic TA implementation plan for the duration of the adviser's services, and detail the adviser's and other consultants' responsibilities. Subsequent to the inception report, the international adviser will submit to MOF and ADB reports detailing TA progress at three-month intervals. The progress reports will be reviewed at joint meetings attended by the deputy minister responsible for the PIP Department, head of the PIP Department, ADB, and PIP adviser. The last such report will be completed as the final report of the PIP adviser, and will provide a comprehensive description of the TA outcome and a detailed assessment of the results achieved in meeting its objectives. Owing to the TA's strategic nature and importance, the Government has indicated that it will accord the same priority and attention to detail in implementing the second phase TA as was done during the first phase TA.

## **IV. THE PRESIDENT'S DECISION**

10. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance, on a grant basis, to the Government of the Kyrgyz Republic in an amount not exceeding the equivalent of \$600,000 for Strengthening Capacity of the Ministry of Finance for Financial Management and Planning of the Public Investment Program, Phase II, and hereby reports such action to the Board.

### TECHNICAL ASSISTANCE FRAMEWORK

| Design Summary   | Performance Targets   | Monitoring Mechanism  | Assumptions and Risks  |
|--|---|---|--|
| <p><b>Goal</b></p> <p>Improve financial management, prioritization, and implementation of the Public Investment Program</p>  | <p>Successful realignment of the PIP level to more sustainable levels as determined by the International Monetary Fund</p>  | <p>Quarterly progress reports and review meetings</p>                   | <p>The Government will ensure that the expenditures of line ministries are within the limits set for the PIP under the Poverty Reduction and Growth Facility (PRGF).</p>   |
| <p><b>Purpose</b></p> <p>To reduce the rate of accumulation of external debt and reduce it to more sustainable levels</p>  | <p>Implementation of the debt reduction strategy</p>  | <p>Quarterly progress reports and review meetings</p>                   | <p>The fiscal consolidation plan envisaged under the PRGF is strictly adhered.</p>   |
| <p><b>Outputs</b></p> <p>Institutional strengthening of the Ministry of Finance (MOF) for planning, financial management, monitoring, and implementation of the PIP</p> <p>On-the-job and formal training programs</p> | <p>Reassessment of the organizational structure of MOF based on the experience gained during the last one year</p> <p>Preparation of a medium-term PIP plan</p> <p>Improvement in monthly reporting systems to monitor physical and financial parameters and strict adherence to budget targets</p> <p>Formal training programs</p> <p>Interdepartmental workshops/seminars</p> | <p>TA reports</p> <p>Quarterly progress reports and review meetings</p> | <p>Cooperation from the staff of MOF, project implementation units and line ministries will be forthcoming.</p> <p>Staff trained under the technical assistance (TA), and particularly, from the PIP Department, are retained in their respective departments for a reasonable period of time.</p> |

(Reference in text: page 1, para. 1)

| <b>Activities</b>  |  |  |  |
|--|--|--|--|
| Review organization of the PIP Department to enhance its coordination and information exchange with PIUs                           | Organization review completed and capacities of the PIP Department developed for effective coordination and information management | Quarterly progress reports and monthly review meetings | The Government is committed to implementing the organizational and institutional changes recommended under the TA.   |
| Institutionalize project appraisal and prioritization processes  | Project appraisal and prioritization undertaken under viable criteria in the PIP management system                                 |  | The Government is committed to allocating appropriate counterpart staff resources, and data to undertake activities. |
| Prepare a medium-term PIP plan with an optimal mix of ongoing and new projects   | A viable medium-term PIP plan prepared and implemented by the Government   |  |  |
| Enhance the scope of the monthly reporting system to make it an instrument for planning, monitoring, and enforcement               | A complete monthly monitoring and reporting system established   |  |  |
| Improve cash-flow management and planning  | An effective cash-flow management and planning system operationalized  |  |  |
| Streamline methods used to estimate recurrent costs and develop procedures for integrating the information into budget forecasting | The methods streamlined and new procedures adopted   |  |  |
| Train staff  | Adequate staff trained and capacities developed for PIP management   |  |  |
| Assist in implementing the new Budget Law  | The new Budget Law enforced  |  |  |

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

### A. Adviser Public Investment Program (International, 18 person-months)

1. The consultant will report to the Ministry of Finance (MOF) and provide regular work reports as needed in addition to those required for technical assistance (TA) implementation (paras. 8 and 9 of the TA). The consultant will observe Government regulations and policies, particularly those of MOF, and be assisted by two domestic consultants to carry out the following main responsibilities:

- (i) Taking into account the recent reorganization of MOF and the functional analysis carried out under the first phase TA, reexamine the functional relationship of the PIP Department with other departments in MOF and pertinent line ministries and project implementation units. Make recommendations for streamlining the functional relationships to enhance the coordinating role of the PIP Department to improve its project implementation capacity and the quality and timeliness of information flows.
- (ii) Refine the PIP prioritization exercise carried out under the first phase in consultation with the Government and funding agencies. Improve and institutionalize project appraisal and PIP prioritization processes with follow-up training, and development of appropriate regulations and manuals. The regulations and manuals should be comprehensive enough to accommodate the broad sectoral complexities of physical infrastructure, social sector, and financial intermediation type projects.
- (iii) Refine and institutionalize the capacity of the PIP Department in reappraising ongoing projects for their prioritization based on reassessed benefits and implementation performance. Develop guidelines for resource allocation based on the reappraisal results. Assist the Government in developing a medium-term public investment forecast (up to 2005) with an optimal mix of budgetary resource allocation for the ongoing and new projects.
- (iv) Refine and expand the scope of the existing monthly reporting system of the PIUs and line ministries to achieve the following objectives: (a) enforce strict adherence to budgetary allocations both in terms of actual spending and future contractual commitments/obligations; (b) determine cash flow requirements of projects based on physical progress and past contractual commitments/obligations; and (c) institute incentives and accountabilities to ensure timely and accurate reporting of expenditures, commitments, and future obligations.
- (v) Improve the present method of forecasting monthly cash flow and annual expenditure requirements of the PIP to internationally acceptable standards. Develop appropriate algorithms and procedures to link the monthly reporting system to determine and prospectively revise cash flow requirements and annual budget commitments of the PIP for accurately and continuously assessing its budgetary implications.

(Reference in text: page 3, para. 6)

- (vi) Establish internationally acceptable methods and procedures to estimate and forecast investment and recurrent/maintenance cost requirements of the ongoing, about to be completed, and completed projects. Develop methods and procedures to integrate these estimates into the medium-term budgetary forecasts. Recommend organizational changes required to achieve the necessary level of interagency coordination to fulfill this objective.
- (vii) Suggest the steps needed to enhance the capacity of the PIP Department to identify, analyze, and resolve project implementation bottlenecks arising from the lack of interministerial/agency coordination to speed up project implementation. Enhance the project identification capacity of the PIP Department in consultation with line ministries.
- (viii) Determine the staff training needs to fulfill the tasks envisaged in (ii) – (vi) above. Plan and prioritize training programs in consultation with the PIP Department and line ministries and agencies. Advise on the selection of the international training specialist and help ADB develop the terms of reference for the specialist. Coordinate, participate in as appropriate, and supervise the training program.
- (ix) Assist the Government with implementation of the new Budget Law.
- (x) Cooperate and coordinate activities with other ADB-funded consultants or advisers to MOF key economic agencies, and other line ministries.

**B. Training Specialist (International, 2 person-months)**

- 2. The international consultant will provide training in the broad areas indicated in (ii)-(vi) para. 1 above, which describe the terms of reference of the PIP adviser. Detailed terms of reference for the specialist will be determined by ADB in consultation with the international PIP adviser.

**C. Financial and Systems Specialists for the PIP (Domestic, 36 person-months)**

- 3. The two domestic consultants will do the following:
  - (i) responsible and report to the PIP adviser;
  - (ii) assist the PIP adviser in carrying out the tasks described in para. 1; and
  - (iii) advise and train staff at MOF, relevant line ministries, and agencies in various aspects of the TA.

**Cost Estimates and Financing Plan**  
(\\$)

| Item   | Foreign<br>Exchange | Local<br>Currency | Total<br>Cost  |
|--|---------------------|-------------------|----------------|
| <b>A. Asian Development Bank Financing<sup>a</sup></b> |                     |                   |                |
| 1. Consultants   |                     |                   |                |
| a. Remuneration and Per Diem                           |                     |                   |                |
| i. International Consultants                           | 450,000             | 0                 | 450,000        |
| ii. Domestic Consultants                               | 0                   | 24,000            | 24,000         |
| b. International and Local Travel                      | 14,000              | 5,000             | 19,000         |
| 2. Equipment and Office Supplies                       | 0                   | 12,000            | 12,000         |
| 3. Training, Seminars, and Conferences (In-country)    | 0                   | 15,000            | 15,000         |
| 4. Miscellaneous Administration and Support Costs      | 0                   | 20,000            | 20,000         |
| 5. Contingencies                                       | 60,000              | 0                 | 60,000         |
| <b>Subtotal (A)</b>                                    | <b>524,000</b>      | <b>76,000</b>     | <b>600,000</b> |
| <b>B. Government Financing</b>                         |                     |                   |                |
| 1. Office Support                                      | 0                   | 48,000            | 48,000         |
| 2. Counterpart Staff                                   | 0                   | 30,000            | 30,000         |
| 3. Communications (local)                              | 0                   | 6,000             | 6,000          |
| 4. Miscellaneous Administration and Support Costs      | 0                   | 22,000            | 22,000         |
| <b>Subtotal (B)</b>                                    | <b>0</b>            | <b>106,000</b>    | <b>106,000</b> |
| <b>Total</b>   | <b>524,000</b>      | <b>182,000</b>    | <b>706,000</b> |

<sup>a</sup> Funded from the Asian Development Bank technical assistance program.  
Source: Staff estimates.

(Reference in text: page 3, para. 7)